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& Disputes

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Supreme Court: the VA Must Apply the "Rule of Two" in all Contracting Decisions

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On June 16, 2016, the U.S. Supreme Court unanimously ruled that the U.S. Department of Veterans Affairs (VA) must give preference to veteran-owned small businesses for all VA procurements as long as the requirements of the "Rule of Two" are met. This decision will drastically alter the landscape for VA procurement, because the VA currently only awards 10 to 12 percent of its contracts to veteran-owned small businesses.

In *Kingdomware Technologies, Inc. v. United States*, 579 U. S. ____ (2016), the U.S. Supreme Court sided with a service-disabled veteran-owned small business (SDVOSB) who challenged the VA's application of Veterans Benefits, Health Care, and Information Technology Act of 2006, 38 U.S.C. §8127 (the Act), which requires that the VA "shall award contracts" on the basis of competition restricted to veteran-owned small businesses (VOSBs) and SDVOSBs if there is a "reasonable expectation" that at least two such businesses will bid on the contract and that "the award can be made at a fair and reasonable price that offers best value to the United States"—known as the "Rule of Two." 38 U.S.C. §8127(d).

Around January 2012, the VA decided to procure an Emergency Notification Service for four medical centers. The VA sent a request for a price quotation to a non-veteran-owned company through the General Services Administration (GSA) Federal Supply Schedule (FSS) system. That company responded with a price that was accepted by the VA, which issued a FSS order to the company. Kingdomware Technologies, Inc. challenged the VA's decision to award the contract by filing a bid protest with the Government Accountability Office (GAO), alleging that the VA procured the contract through the FSS system without restricting competition to SDVOSBs by using the Rule of Two. The GAO sustained Kingdomware's protest, finding that the VA's failure to employ the Rule of Two was unlawful. The VA disagreed with the GAO's decision and refused to follow it.

Kingdomware then filed suit in the U.S. Court of Federal Claims (COFC) and sought declaratory and injunctive relief. The COFC, instead, granted summary judgment to the VA, ruling that the Act did not require the VA to use the Rule of Two in all procurements, and finding that its application was limited to those acquisitions necessary to fulfill the VA's annual contracting goals described in the Act.

Kingdomware appealed to the U.S. Circuit Court of Appeals for the Federal Circuit, where a divided panel affirmed the COFC decision. See *Kingdomware Technologies, Inc. v. United States, 754 F. 3d 923 (2014).* The dissenting opinion, however, argued that the Act employs mandatory language, requiring the VA to apply the Rule of Two in every instance of contracting. *Id.*, at 935.

Kingdomware appealed to the U.S. Supreme Court, where, in a unanimous decision authored by Clarence Thomas, the Court reversed the Federal Circuit's ruling and concluded that the VA must use the Rule of Two when awarding contracts, even when the VA will otherwise meet its annual minimum contracting goals. The Court also ruled that the VA cannot evade the Rule of Two by placing an order through the FSS.

The Court reasoned that "Congress' use of the word 'shall' demonstrates that §8127(d) mandates the use of the Rule of Two in all contracting before using competitive procedures." The VA argued that, despite the use of the world "shall," the Rule of Two should be discretionary because the prefatory clause to §8127(d) declares that the Rule of Two is designed "for the purposes of" meeting the annual contracting goals that the VA is required to set under §8127(a). The Court, however, found that "the prefatory clause has no bearing on whether §8127(d)'s requirement is mandatory or discretionary" because it merely "announces an objective that Congress hoped that the Department would achieve and charges the Secretary with setting annual benchmarks, but it does not change the plain meaning of the operative clause."

The VA also argued that, even if mandatory, the Rule of Two "does not apply to 'orders' under 'pre-existing FSS contracts'" claiming that task and delivery orders under FSS contracts are not "contracts" as defined by the Act. The Court disagreed, finding that "[w]hen the Department places an FSS order, that order creates contractual obligations for each party and is a 'contract' within the ordinary meaning of that term," and that "[a]n FSS order creates mutually binding obligations: for the contractor, to supply certain goods or services, and for the Government, to pay."

The Supreme Court's decision in *Kingdomware* will drastically alter the landscape for VA procurement, which currently awards only 10 to 12 percent of its contracts to veteran-owned small businesses. It is estimated that the VA uses FSS contracts to issue approximately 85,000 orders each year. Therefore, the VA's extension of the Rule of Two to each FSS order will create substantial additional opportunities for VOSB and SDVOSB contractors. Nevertheless, as the VA may not immediately implement the Supreme Court's ruling, VOSB and SDVOSB contractors now have the opportunity to independently enforce this decision through the bid protest process at the GAO and the COFC.

If you have any questions about the content of this Alert, please contact the Pillsbury attorney with whom you regularly work, or the authors below.

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